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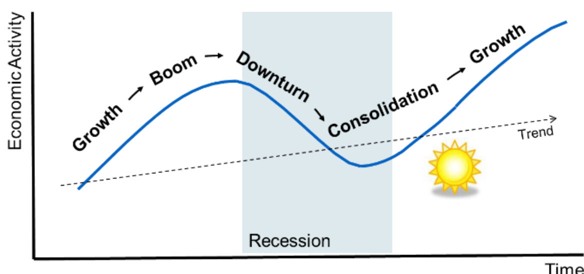
Briefing from the ARVEST Investment Committee

In the first quarter of 2021, the expectation of overcoming the pandemic and of a strong economic recovery has become more firmly established. The recovery is likely to be bumpy in parts of the world, as new waves of pandemics threaten to curtail the economy, as is currently the case in Uruguay, Turkey and parts of India. However, economic forecasters are generously dismissing this, and the financial markets and also we basically share this approach.



In the last three months, cyclically sensitive equities in particular have benefited from the expected economic upswing. As discussed in our last investment commentary, this was not unexpected. Increased economic confidence among investors was also reflected in a weakening of the Swiss franc. Investors are once again venturing out of the safe haven of Switzerland into the wider world. This even holds true with regard to the Eurozone or Great Britain, after neither Brexit nor the very strict protective measures against the pandemic there immediately led to the feared economic fiasco. The bond markets also appeared in line with a scenario of an incipient economic upturn. In the US dollar area in particular, longer-term yields rose markedly in the first quarter, driven by a combination of expectations of real growth and temporary inflationary pressure. This led to price losses, particularly for bonds with long maturities. At the same time, market participants continue to firmly expect central banks in the industrialized countries to leave prime rates at or below zero for at least another one to two years.

The stock markets have therefore had a roaring start to the year. So are we already back in a stock market bubble? Indeed, investor behavior in parts of the market, especially with U.S. technology companies that are new to the stock market, is increasingly exhibiting the typical signs of a bubble in the making. New groups of buyers, such as millennials organizing themselves in social networks or closed hedge funds like Archegos, are betting

on higher prices for technology stocks with high leverage amid widespread euphoric investor sentiment, which can hardly be justified by fundamental valuation metrics due to the thin track record of those tech companies to date. But one important indicator of a bubble is still missing. For example, there are hardly any companies buying futures to hedge against rising costs on the commodity or interest rate markets, as they used to do in earlier bubbles. Nor are companies hoarding inventories or pulling forward investments, as they would do in anticipation of rising product costs. Indeed, in the past, equity bubbles burst later in the business cycle, after the economy had reached its capacity limits and cyclical inflationary pressures had been able to build up.

Reaching new highs in stock market indices so soon after the end of a recession is unusual. Usually, investors feel a lower risk appetite for some time after the losses suffered. Moreover, the real economy has always been first to absorb the liquidity created by the central banks. This time was different. To this day, many services may not be offered. Thus, the liquidity does not serve consumption in the real economy. The financial markets, on the other hand, were already digitalized before the pandemic and were not affected by any official closures. We therefore explain the strong stock market performance primarily with the liquidity which was accumulated and which, due to unattractive interest rates, quickly flowed from bank accounts to the stock markets, irrespective of their absolutely high valuations.

Future Prospects

The ARVEST Investment Committee sees the global economy, on the whole, at the beginning of a growth phase. Last year's recession was triggered by an external economic shock, namely the protective measures against the pandemic, and not primarily by an overheated economy itself. We expect strong economic growth in the second half of the year. However, this is just a recovery from a recession and not a boom phase in an overheated economy. Accordingly, we are currently allocating a high weighting to equities in our cyclical investment strategies. Despite the high stock market prices, which imply below-average long-term price performance, there is no convincing alternative to equities and real assets on the financial markets. We manage the high valuation risks with a targeted selection of individual stocks and a portfolio structure that can deviate significantly from the sector and country composition of the broad stock indices. As mentioned, investors and also central banks expect only transient increases in consumer prices. Various other risks, such as rising corporate taxes or increasing political influence on global supply chains or corporate financing in the wake of the China-US supremacy conflict, are largely ignored by investors. We prefer stocks that we expect to perform relatively better should the corresponding risks increase further or should these scenarios even materialize. Fortunately, such investments currently seem to us to be valued comparatively attractively.

12 April 2021
On behalf of the Investment Committee
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Chief Investment Officer ARVEST Funds AG

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